“The development of multiple payment types is increasing the pressure on these businesses as consumers demand the ability to make payments through Apple Pay, for example. Many companies will have little choice but to accept a wider variety of payment types”

What’s the alternative?

A HOST OF INNOVATORS ARE CHALLENGING THE POWER OF THE BANKS THAT HAVE TRADITIONALLY DOMINATED THE PAYMENTS INDUSTRY. PAUL GOLDEN EXPLAINS HOW

IMAGE SOURCE

Payment applications developed by companies outside the traditional banking system account for a growing share of financial transactions, raising the prospect of lower payment-processing costs for corporates.

According to international consulting firm Accenture, competition from non-banks could reduce traditional bank revenues by a third by 2020, with payments one of the most hotly contested areas.

Meanwhile, the most recent edition of the alternative payments report, produced by payment-processing provider Worldpay, reveals that the value of payments processed by more than 300 alternative payment schemes in operation globally rose by 21% in 2013. It estimates that they will account for 59% of transactions by 2017.

One of the most commonly referenced benefits of alternative payment systems is reduced transaction costs, although Stephen Baseby, ACT associate policy and technical director, says that the costs faced by businesses vary widely.

“The higher the transaction volume and average transaction size, the cheaper electronically processed payments are, which means that processing costs can be surprisingly low for a large utility relative to income, but high for a small retailer,” he explains.

Interchange fees – the fee paid by a merchant’s acquiring bank to a cardholder’s issuing bank as part of an electronic payment card transaction – are in flux (see box on page 31) and the impact of recent changes is not yet clear, Baseby continues.

He says: “Most of the payment applications generate a Faster Payment, which accounts for the bulk of the cost. Payments made via Faster Payments – a UK banking initiative to reduce payment times between different banks’ customer accounts – remain expensive relative to debit cards. This is partly down to the volume of transactions, although that should change as volume increases.”

Daniel Blumen, founding partner of consultancy Treasury Alliance Group, observes that, for businesses that deal with individual consumers, payment processing and interchange charges can be a significant expense.

“The development of multiple payment types is increasing the pressure on these businesses as consumers demand the ability to make payments through Apple Pay, for example,” he says. “Many companies will have little choice but to accept a wider variety of payment types.”

As a result, Blumen says it is difficult to predict whether the growth of alternative payment will drive down costs. “This could be the case, but then there is the added cost of accepting a large number of payment methods. What makes alternatives such as Dwolla and PayPal attractive is that some of the cost of the payment falls on the consumer.”

Convenient for customers

Homer Wu, treasurer at international retail marketing firm TCC, observes that some alternative payment mechanisms are simply a means of storing credit cards digitally, since consumers still need to have a credit or a debit card to make use of payment systems such as Google Wallet.

“The value proposition for the consumer is the increase in convenience, and the attraction for the retailer is to reduce the time required per transaction,” he says. “In this scenario, I don’t see how alternative payment systems >

reduce processing fees, unless you take that time saving into consideration."

No matter how the payment is instructed, it will end up in the banking system for delivery unless an alternate system, such as Bitcoin, is used, agrees Baseby, adding that delivering usable funds is a major challenge for alternative payment providers.

"You can have as many retailers, providers and end users as you want, but the core transmission networks are monopolies, so who is going to be able to justify building a parallel network?" he adds.

Blumen states that, while there has been a rush of investment into new payment systems, it is hard to say exactly how many alternative payment services the market could support, and that there will be an inevitable shakeout in the industry.

"Alternative payment providers would love to use their own platforms and operate a closed loop – such as Bitcoin – since costs are lowest this way," says Blumen. "But that requires the buyer and seller to be on the same system, which is asking a lot. The banks are also fighting back with their own customer-to-customer options, which do not use the conventional clearing systems, such as ACH [Automated Clearing House]."

Treasury Alliance Group's view is that companies that offer an easy front end into existing systems (such as Dwolla) will do well, while systems that require closed loop will be appealing in the short to medium term until a major fraud event leaves those holding large amounts of Bitcoin out of pocket.

Gene Neyer, senior vice president product management at transaction banking software provider Fundtech, observes that initiatives such as merchant-owned mobile commerce network MCX have been slow to take off and that payment mechanisms with very low fees and no interchange are not being adopted widely.

Yet he also states that the new European Payment Services Directive is creating a competition framework, where alternative providers can insert themselves between the consumer and their banks, which is expected to significantly increase the number of alternative providers and competition.

"The significant issues are the capital requirements necessary to implement the new EMV [an open-standard set of specifications for smart card payments and acceptance devices], which many smaller retailers will not be able to afford, and the shift in the liability model for fraud," says Neyer.

Working smarter

"Alternative providers will continue to use the banks' infrastructure, but in smarter ways, such as netting, grossing up, offsetting debits/credits and implicitly extending (micro) credit based on alternative criteria," Neyer continues. "Those with roots in cryptocurrency are looking to create a new platform in the form of block chains and

"Until there is standardisation in how these transactions are conducted, it may be cumbersome to offer access to multiple mobile payment types"

IMPLICATIONS FOR TREASURY

One of the most intriguing potential applications of alternative payment systems is for making and receiving corporate treasury payments. A number of treasury management system providers are understood to be looking at how their systems might support alternative payment applications.

But RB Erickson, director of global sales enablement at treasury software company Kyriba, says he is unaware of any corporate treasury department using mobile payment solutions.

"I suspect that we will see the adoption of Google Wallet and Apple Pay from the receivables side. For corporates that receive online retail payments from customers, corporate treasury may monitor these from a forecasting or cash-balancing perspective. But while corporate treasuries may not elect to make their own payments via Google Wallet or Apple Pay, some may require links with these payment methods to project incoming cash flows or set cash balances."

Treasurers are not likely to use even established payment methods such as credit cards to initiate payments because most of them are supposed to be almost free and executed quickly, adds Jerome Albus, senior vice president of payments and messaging for SunGard's corporate liquidity business.

"In that context, treasurers are better served by having the smallest number of intermediaries to avoid additional fees from the credit card providers. Also, treasury payments often involve a multitude of accounts, whereas a card is attached to a single debit account. Some companies have hundreds of debit accounts and treasurers would not want to manage or run the risk of having a payment card attached to each one of them," says Erickson.

open shared ledgers. As soon as they are used to transfer and store funds, however, they immediately come under the regulatory umbrella and, at a minimum, must become registered money transmitters."

Despite the challenges outlined above, Nick Holland, head of mobile at Javelin Strategy & Research, floats the possibility of Apple starting its own payment network and expects alternative payment providers to look at acquiring money-transfer licences.

Holland says some may become banks in their own right or absorb existing banks. "We will also see traditional payment providers building out person-to-person networks with real-time transfer of funds."

According to Paul McMeekin, director, market intelligence, at electronic banking solutions provider ACI Worldwide, the major competitive concern for banks is that Google will give away the transaction and become a 'real' bank. This point is taken up by his colleague Mark Ranta, who says that Google is happy to forgo the transaction fee to earn multiples of that amount on the associated advertising space.

McMeekin says there is considerable potential for tie-ins between banks with sizeable market share and companies that bill large numbers of customers, such as mobile operators. "If an operator worked directly with a bank, it could develop a smartphone app that would allow the customer to directly access their funds."

One potential obstacle to such partnerships is data ownership, adds Ranta. "Both the bank and the merchant will want to own the customer data, but the network operator will also stake a claim to it. There will have to be sharing of information between all parties."

Merchants may accept multiple payment types, but will, at some point, reach a limit as to how many they can support at the register, says Steve Kenneally, vice president at the American Bankers Association's Center for Payments and Cybersecurity.

"Until there is standardisation in how these transactions are conducted, it may be cumbersome to offer access to multiple mobile payment types," he concludes. "Right now, it is not clear if the best way to make payments faster, safer and more efficient is to build upon a legacy system like the ACH or card networks, or to create a brand-new platform with technology specifically for real-time payments."

IMAGE SOURCE

THE COST OF PAYMENTS

Richard Koch, head of policy at the UK Cards Association, describes payment processing and interchange fees as part of the costs of doing business. He refers to a European Central Bank study, undertaken in 2012, which found that card-acceptance costs amounted to less than 0.2% of retailers' total costs.

Yet Nick Holland, of Javelin Strategy & Research, observes that there is deep dissatisfaction among US retailers with the two major card companies in relation to the interchange fees they charge.

In the UK, the Payment Systems Regulator (PSR) is undertaking a study into payment card systems, including the fees charged to the businesses that use them. A 'call for input' was published in late June on issues such as the impact of the EU Interchange Fee Regulation.

As well as gathering views and information on how people think the Interchange Fee Regulation will work in the UK and developing a policy for monitoring compliance, the PSR is also seeking views on possible concerns around indirect access and governance of card payment systems.

A spokesperson for the regulator said that one of its key roles was to open up payment systems so that more people are able to access them. "To support this, we must promote the development of technical access solutions that should ultimately contribute to driving processing fees down."

One of the PSR's proposals is that innovative payment service providers should be able to gain direct access to payment systems on fair terms.

Paul Golden is a freelance journalist who specialises in writing about finance